RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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THE PICTURE: When trouble hits, politicians invariably want to cover their fannies or shift the blame to someone else. By the same token, businessmen want to say something which will bolster the economic outlook or boost faith in their own businesses. As for the press, the press doesn't understand much about economics, and it will usually mouth whatever an interviewee tells it or whatever makes a good story. Moreover, the press is super–liberal and generally anti-wealth, so much of what you read in newspaper editorials and comments will be useless blather, hand-outs, and hearsay.

Over the past few weeks newspapers, radio, and TV were chock-full of interviews with prominent businessmen and politicians, along with polls analyzing the average American's reaction to the big fiasco on Wall Street.

I've been asked repeatedly what I think the market is really saying, so I might as well join the "opinion parade." To my mind, this bear market is about TAKING THE PAIN. Year after year, the US has been spending billions of dollars more than it has taken in, running up shameful and outlandish budget deficits. Every president since Eisenhower has run his campaign on a pledge to balance the budget. Each president has failed to balance the budget and Congress, of course, can fully share the blame.

So the US standard of living through the years has been marvelous, and it's all been done by borrowing from the future. The lofty living conditions of the 1970s and '80s have all been done with mirrors, and the mirrors have reflected the debt -- shifted it off to future generations. Our kids and our grandchildren were supposed to take the pain of paying off trillions of dollars of debt while today's cowardly politicians played the song which goes, "vote for me, I gave you the good life, and it only cost you 50 cents on the dollar."

But the law of market karma thought differently. The law of market karma said, "Pay the piper -- take the pain." The bear signal of October 15 and the crash of October 19 (and the action that followed) was the market's way of saying, "I'm mad as hell about the debts and the deficits, and I'm not going to take it anymore."

I've felt all along that only the markets would be capable of capturing the attention of the political wind-bags in our Capitol. Moreover, I've felt that only the markets would be able to force a halt to Washington's 40-year spending orgy. Finally, I've been of the opinion that only a collapsing stock market could get Reagan and Congress off their pulpits and of a mind (or at least, frightened enough) to take the deficits seriously.

But finally, here in 1987, the picture has changed. Today, foreigners (our creditors) can make or break the dollar. When foreigners don't want dollars, they dump them. The dollar then turns weak, the bond market caves in, interest rates ratchet up, and the stock market swoons.

What we've seen in the markets in October is what I term "**the big warning.**" The markets are warning us that we must cut back on the deficits no matter what the consequences, be those consequences a recession, a depression, a decline in the American standard of living or what have you. The crash of '87 is telling the US public and Mr. Reagan and Congress and everyone else that the spending orgy is coming to a close and that THE DEFICITS MUST BE ADDRESSED.

So I scratch my head, and I say, "OK, I guess I wrote about as many bearish articles about this market during 1987 as anyone. I feel I did my job. What can I write about now that might help my subscribers?" I believe a comparison, at least in the market action of 1987 and 1929, will be useful and worthwhile.

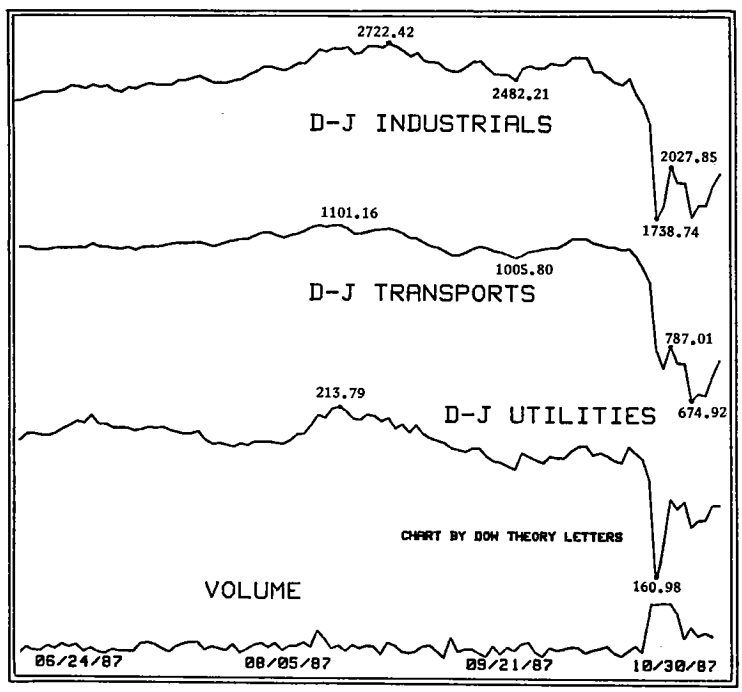
Unfortunately, very few people understand how markets work or what market moves portend. In proof, simply go back and read the rash of ignorant statements that were published right up to the time of the October crash -- embarrassingly stupid statements from all quarters including, sad to say, the investment advisory industry.

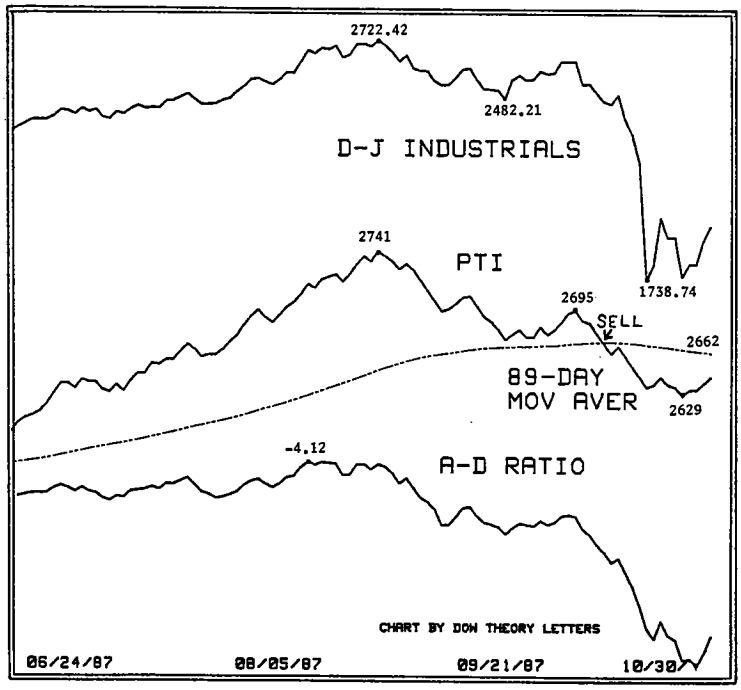
Let's talk about what we really know at this point? We know that the Dow Theory signaled a primary bear market on October 15. We know that on October 19 (two trading days later) the stock market produced the worst crash in Wall Street history, with the Dow plunging an incredible 508 points on record volume of 608 million shares. The one-day loss for the Dow was 22.6%, almost twice the 12.8% loss during the worst day of the 1929 crash.

By October 19, 1987 the Dow had collapsed to a closing low of 1738.74. This meant that from its August 25 peak of 2722.42 to its October 19 low, the Dow had lost a shocking 36.1% of its value.

On October 20 the market began a violent surge, a surge which saw the Dow (on October 21) close at 2077.38. The two-day rally resulted in a recouping of 34.4% of the losses since the August high. Nevertheless, the recovery (so far) has been sub-normal, since most post-crash recoveries tend to retrace roughly half of the preceding losses.

The question of the moment is -- did the two-day recovery following the crash low represent all the upside correction we're





going to see -- or is the market still fishing for the bottom of the first down-leg of the bear market? I wish I had the answer to that one, but I don't and neither does anyone else. As this is written, the Transports have already plunged below their October 19 crash low point and it remains to be seen whether Industrials will follow.

Thus, the October 19 crash low of 1738.74 for Industrials becomes a critical point. If the Dow breaks below that level I would say that it would amount to a continuation of the crash action.

On the other hand, if the Dow stubbornly holds above 1738.74 the market could be building up technical steam for a FULL 50% correction of the ground lost (a full 50% retracement would take the Dow to roughly 2230).

I must say that the market action following the crash has been anything but inspiring. Despite the fact that the market is massively over-sold (which is typical of a primary bear market), breadth has been ghastly on days when the Dow declines and weak on days when the Dow rallies. In fact, (see page 2 chart), the advance-decline ratio has been sinking to new lows almost daily. My PTI remains in a definitive downtrend, and DowPow has fallen off the bottom of the chart. But as I said, **whether Dow 1738.74 holds or not** will tell the story over the near-term.

I've been asked the question, "Couldn't the whole bear market be over now, since we've already experienced an historic 36% crash in the Dow and an even worse smash in the rest of the market?"

Optimist's View: I'm well aware of the old adage which states that "the stock market can do anything." But in view of the above question, let's examine the "it's all a terrible mistake" position. This position states that the whole 1987 market mess was man-made and intentional, but that it simply got a bit out of hand. The argument continues: The Fed was worried about inflation, and it had been tightening credit all year. As a result, the bond market was hit unmercifully. Collapsing bonds resulted in the ratio of stock to bond yields getting totally out of line -- and under the strain of this, the stock market simply crashed.

Following the crash, perceptions changed -- literally overnight. Fears of inflation turned to fears about recession, depression, illiquidity, and mass bankruptcies. Doing a total about face, the Fed opened the money floodgates while Fed Chairman Greenspan announced that the Fed would stand behind the system. Congress made new vows to cut the deficits and Reagan, in a sudden about face, announced that he would not be opposed to higher taxes. In the face of new found encouragement, interest rates declined sharply, bonds exploded, and gold shares caved in.

So to review the optimists' perception: "It was a man-made money squeeze, now the Fed is de-squeezing, inflation is under control as is deflation, and all is right (or all will be right) in the economic and the financial world."

So much for the "it ain't a bear market, and even if it was, it's probably over" view. That's a view which, in case you haven't guessed it, I do not subscribe to.

Russell's Bear Market View: As I see it, we are experiencing the early stages of a primary bear market, a bear market which I believe has a considerable distance (in both duration and extent) to go.

Let me start this section with a single thought. The crash of '87 was not something that came out of the blue. No, it was the logical culmination of a long series of technical events, a series that began back in January 1987. January was the month when the bellwether D-J Utility Average topped out at 227.83. In March the advance-decline ratio hit a bull market peak and turned down. On August 11 the D-J Transportation Average hit its bull market peak of 1101.16, and it too turned down. Finally, on August 25 the Industrial Average recorded its bull market high of 2722.42, and it too joined the downside parade.

All this, remember, occurred during the third (speculative) phase of the bull market. This is the phase where stocks rise far above valuation, where volume is large, where rumors are flying, and where the public finally jumps in with both feet (they did it this time via mutual funds). *It is only in the third phase of a bull market that a bear signal is valid (in the sense that it signals a turn from primary bull to primary bear market).*

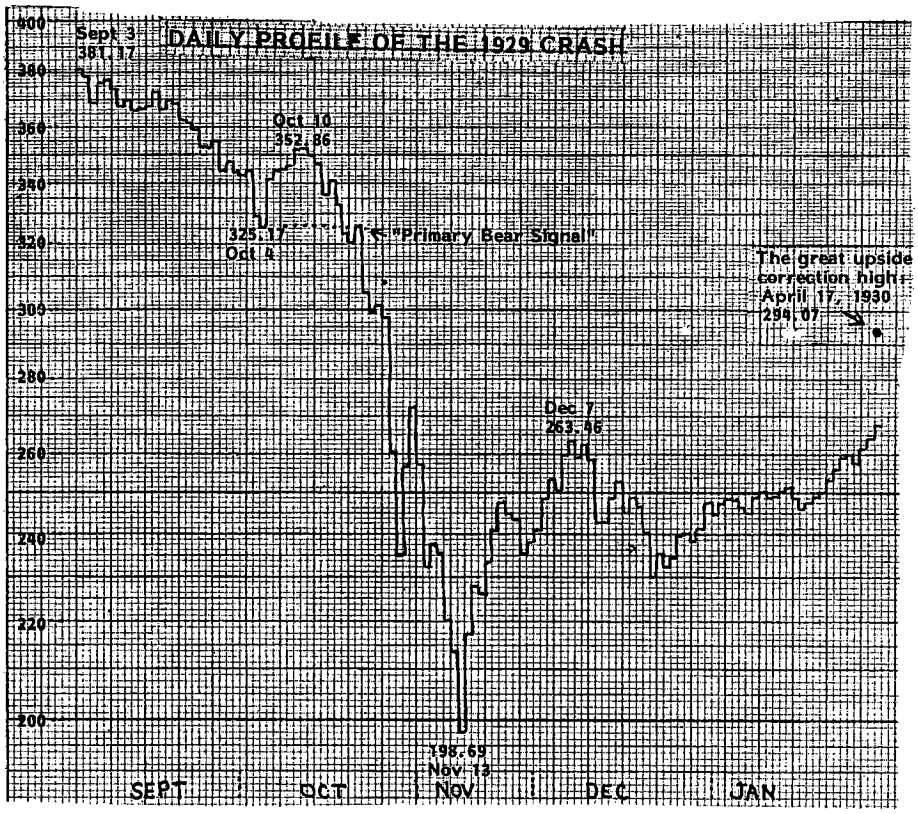
Thus, we see that a giant bull market top was in the process of formation all during 1987, from January to August. When the market crashed in October, *it wasn't the result of some isolated event.* Hardly! The market had been in the process of distribution (i.e., stocks passing from strong hands to weak hands) for nine months. And these thoughts aren't something I dreamed up in retrospect. I have been writing about them, warning about them, ALL YEAR!

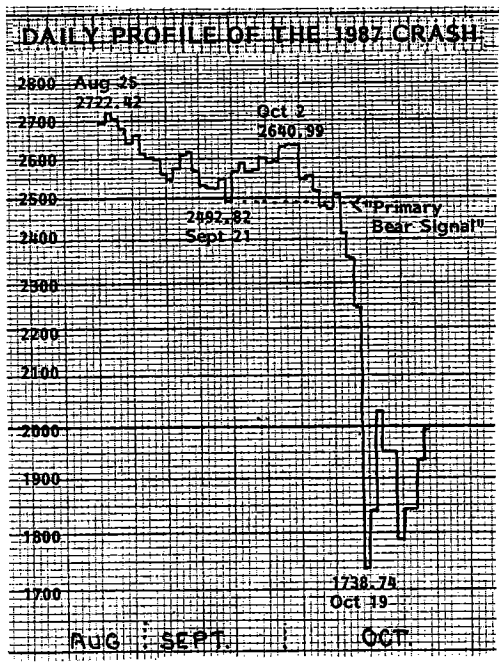
This is where I feel a study of history and a few comparisons will be worthwhile. We know that no two bull markets and no two bear markets are exactly alike -- but there are always similarities. In all stock market history there have been very few market crashes. A crash is an extremely rare event. The nearest price action to what happened this October is the crash of 1929.

Nevertheless, very few people (or market analysts, for that matter) have really studied what happened in 1929. But the 1929 action is well worth studying in detail (and don't get me wrong, I'm not saying that we must have another Great Depression or another 89% drop in the Dow, I'm simply saying that the price action of the two periods shows a great many similarities).

I have drawn a chart of the daily price action of the Dow from September 1929 through January 1930. The Dow hit a bull market high of 381.17 on September 3, 1929. It turned down from there and sank to a low of 325.17 on October 4. The Dow then rallied for only five days to an October10 high of 352.86. It then turned down, and on October 19 the Dow broke the October 4 low (confirmed with a comparable break in the Transports), thereby rendering a Dow Theory bear signal. Within a few weeks (amid crash action) the Dow was down to a November 13 low of 198.69. For the Dow this represented an incredible loss of 48% from the September high.

But here's where the picture might be instructive. From the November 1929 low of 198.69, the Dow headed higher in a massive upside correction that carried the Dow to a high of 294.07 on April 17. Thus, the recovery high was seen a full five months





after the crash low. The huge rally recouped 52.5% of the Dow losses sustained during the crash. During the great rally the public and most of Wall Street turned wildly bullish, and it was universally believed that the bull market had been resurrected.

Sadly, that was not to be the case. From its April 17 recovery high, the Dow turned down again. But it wasn't until October of 1930 that the November 1929 crash lows were broken. In other words, it was *11 months after the '29 crash lows that the Dow broke those lows again.*

The only other crash action of interest was the horrendous crash of May 9 to June 10, 1940 (that crash was brought on by the shocking fall of France to the Germans). The Dow at that time collapsed 24.5% within a few weeks. Next, there was a slow tedious recovery that carried to November 1940. From there the market turned down again, but it was not until December 1941 that the Dow broke below its 1940 crash lows. Thus, it was 18 months (following the 1940 crash lows) before the Dow violated its June 10 low.

Conclusion: *Following a crash, it may be a matter of many months before the crash lows are violated. But the odds say that the lows WILL be violated, after which the bear market can be expected to continue.*

Breadth: When the advance-decline ratio starts on a long, downward path, as it did during 1987 (it turned down in March), it is telling us that "the water is running out of the market bathtub." In other words, regardless of what the Dow is doing, the water-line is moving down. Ultimately, if the A-D ratio continues relentlessly down, it is going to take the Dow, the economy, and everything else with it. Therefore, I usually look at the market this way: The Dow is a bar of soap floating in the bathtub, and the water in the bathtub corresponds to the mass of stocks. The Dow (the soap) bobs up and down and draws the attention, but the Dow always is drawn up or down by the water line (the mass of stocks).

By the same token, you can't have the great majority of American corporations sinking into the sunset and a hundred or so blue-chip stocks holding up the market. No, countless thousands of medium to small corporations going down and down are going to take their toll on the leading stocks, on the economy, and on investors' pocketbooks.

Now this is crucial to remember: It takes time for the A-D ratio to rally or decline (because there's a statistical limit to how far the A-D ratio can move in a single day), but the Dow can adjust in a day. And that's exactly what happened on October 19. *The A-D ratio had been going down for seven months or ever since March,* while the Dow resisted mightily. Then came the **big downside adjustment** as the Dow filled in the vacuum and crashed. In one day the Dow adjusted downward -- to the tune of 508 points. That's how fast the Dow can get in gear with the rest of the stocks on the NYSE.

The market loves harmony. And harmony on Wall Street means that ultimately, the Dow, the Transports, the Utilities, and the A-D ratio all get together on the upside or the downside. They'll get together the easy way or the hard way. In October 1987 they got together the hard way.

Note this: In the market it is the most persistent trend that ALWAYS wins out. And in 1987 it was obvious that the most persistent trend was the declining trend in the A-D ratio. The Dow and the Transports hit their last confirmed highs on August 11. After that the Dow went up alone to its final August 25 high. The A-D ratio continued relentlessly down.

With the Transport non-confirmation and the final downturn in the Dow, the bull market's doom was sealed. Technically, one of the clearest and most obvious tops in stock market history was completed. Next came the turn in the tide -- the bear signal. And finally, the great crash of October 19, 1987.

So that's it. As against those who claim that Black Monday was an accident growing out of program trading or disappointment in Mr. Reagan or rising interest rates, I maintain that the crash was the result of a year-long process of distribution on Wall Street. The surprise was not that the crash occurred, the surprise was only in the extent of the crash.

Question: You've mentioned that we're in the first phase of the bear market. What other phases are there?

Answer: Bear markets have three phases. The phases are psychological and may or may not correspond to swings in the actual price movement. The first phase (we're in it now) is the initial collapse. In this phase the bear market wipes out the froth and frivolity of the preceding bull market top. The first bear market phase usually comes "out of the blue," and it arrives against a background of still-rosy economic statistics. The first phase is invariably greeted by DISBELIEF on the part of investors and the authorities.

The second phase is the one where stocks decline in obvious reflection of deteriorating business conditions. This is usually the longest phase, and it is the one that takes stocks back to known (i.e., real) values. The second phase is accompanied by deepening gloom on the part of stockholders and a general public exodus from Wall Street.

The third and final phase of a bear market is the "give up" phase. It is here that the economic news turns black, and the public swears "never to mention Wall Street again." This is the phase where good stocks are thrown over for no other reason than that they are still salable and that cash needs to be raised. In the third phase, stocks sink below known values as yields on high-grade blue-chip issues rise (on average) above 6%. Volume in the third phase (to the despair of brokers) may contract to perhaps one-third or less of that which was seen at the previous bull market top. Amid this despair, however, the seeds of the next bull market begin to germinate.

Question: What worries you most about the current picture?

Answer: I have two main worries. (1) I worry that the nation is in a bind. The US must reduce its spending in all directions, federal, corporate, individual. It must get sane, solvent, and conservative. But if that happens a severe recession or depression is almost guaranteed. I don't want to see that, but I don't know how to get around it. Maybe, a severe recession is what it will take to cleanse the nation, for if you remember, even the Bible talks about "the seven good years and the seven lean years."

Another thought is this: Inflation is not going to work any longer. At the mere hint of inflation, the bond market will collapse and the stock market will follow. No, I believe we are going into a deflationary phase. It might also be well to consider this: No government has ever survived rampant, unchecked inflation. But governments (including ours) have survived deflation.

(2) My second worry is this (and maybe it's a stupid worry). But if there is a single consensus mentality today it is that "this is no 1929." Honestly, I don't think it's 1929 either, but in this business I've learned to be scared to death of too much company. And boy, do we have company when it comes to the "this is no 1929" thesis.

When you think about it, who the devil knows what we have here? All these geniuses who didn't see the bear market coming, what makes them so damn sure that this is nothing like 1929? Furthermore, if it's only half or a third as bad as 1929 (and the depression that followed), that's bad enough. No, this almost annoying complacency worries me -- it really does.

Question: Russell, you wrote bear market articles in the October 19, 26, and the November 2 issue of Barron's. Won't all that exposure and publicity just push the stock market that much further down? Was it a good idea to write those articles?

Answer: First of all, Barron's literally put me in business back in 1958 when I began a series of 17 Dow Theory articles for that newspaper. The Barron's series was instrumental in making technical analysis acceptable (during the '50s technical analysis was anathema --it was a dirty word).

So I owe Barron's a lot. Second, the great Dow Theorists, William Hamilton and Robert Rhea, both wrote for Barron's. Barron's is the rightful home of the Dow Theory. And I want to keep up that tradition. I want people 50 or 100 years from now to be able to see that the Dow Theory called the turn to the upside at the start of the great bull market (1974) and that the Theory called the turn to the downside (October 1987) at the start of the bear market. Those Dow Theory calls appeared in Barron's and nowhere else. After Richard Russell, maybe my son or your son or somebody else's son will call the turns via Dow Theory. But the Dow Theory will last as long as markets are here. Of that I am convinced.

Finally, in answer to the above question, no man or group of men can manipulate the primary trend of the market. If President Reagan announced today that the bear market was over, it wouldn't cause a ripple in the market. No, the primary tide is more powerful than a Richard Russell article, you can rest assured of that!

Question: What do you think of the corporations buying back their own stocks?

Answer: What's happening now is that people (including businessmen) are not taking this bear market seriously. Over 100 corporations have announced that they will be buying back their own shares. This is an utterly stupid outlay of money. Instead of building up cash and liquidity so they can better weather the bad times that are coming, these ignorant corporations are squandering their cash. Frankly, I can't think of anything dumber.

Along these same lines, the President, industry leaders, and economists are lining up to tell us that this bear market is not going to be serious, and that the economy looks basically sound. I call this a disservice to the nation. Our leaders should be taking the bear market seriously, preaching conservatism, and facing the fact that this nation is entering an extended period of economic contraction.

A week after the 1929 crash, President Hoover stated, " ... for the first time in history, the crisis has been isolated to the stock market itself. It has not extended into either the production activities of the country or the financial fabric of the country." (In a statement a day after the crash, Ronald Reagan noted that "the underlying economy remains sound.")

One of every four Americans owns (or did own) stocks. As of now, roughly $800 billion has been erased from the wealth of Americans. This is equal to all the savings of Americans during the 1980s -- all. And I'm supposed to believe that the nation's economy won't be affected by the bear market!

Question: Russell, I note that you place great emphasis on the dividend yield for the Dow, since you emphasized this in your Barron's "Bear Signal" article (Oct. 19) and you have referred to Dow yields many times in your Letters. What's the story with Dow yields now?

Answer: It's true that yields are the best single determinants of value. There's an old saying that "earnings are what your accountant says they are," and I think that is more or less true. But dividends are hard cash that a corporation pays out, and dividends are never raised or lowered without careful study and corporate soul-searching.

One of the items that drove me to caution was the extremely low yields on the Dow during July, August, and September of this year (Dow yields in the 2.6% range). When matched against the near-10% yields on government bonds, this provided a nearly 4 to 1 ratio in favor of bonds over the Dow, a ratio never seen before.

A study of history demonstrates that there is a yield cycle which accompanies the bull/bear cycle in the stock market. Every bull market in history has ended with Dow yields near or below 3%. And every bear market in history has ended with Dow yields near 6% or better.

Thus, if this is a true primary bear market (and I believe it is) we can expect Dow yields to be around 6% or more before the bear market ends. In other words, blue-chip stocks will be great values when this bear market ends.

What's happening with Dow dividends now? My friends at Investment Quality Trends in La Jolla are the keepers of the Dow

dividends records. Here's what they say: "The 12 months dividend for the D-J Industrial Average through June 1987 was $69.36. The new composite dividends for the 12 months through September are $70.62. ... Unfortunately, dividends are NOT rising as rapidly as we hoped. The dividend for the Industrial Average rose by only 1.81% in the third quarter, down sharply from the 4.26% increase in the previous quarter. ... The recent 1.8% rise did virtually nothing to validate the high price of the D-J Industrial Average."

Russell comment: Not only was the dividends yield on the Dow absurdly low during mid-1987, but dividends growth was also low. Conclusion: The Dow was very overvalued value in 1987.

Question: We're in a bear market as far as stocks are concerned. But does that mean that the economy has to go into the tank? Must every Wall Street bear market set off a recession or depression?

Answer: History shows that MOST bear markets in stocks are harbingers of economic contraction. There have been a few exceptions such as the sudden collapse during 1962. At that time (and I remember this as though it were yesterday) President Kennedy damned the steel companies because they had boosted the price of steel in the face of Kennedy's admonitions. The market "fainted" at this Presidential confrontation, and stocks fell out of bed. But the market was technically weak at the time (I was bearish in 1962), and Kennedy's angry words simply acted as the trigger for the decline.

However, in recent history only the 1962 cave-in on Wall Street was confined to stocks alone. Those who are hoping that the 1987 smash will be confined to stocks are, I feel, whistling in the wind. I would expect, at the very least, a recession to set in during late-1987 and beyond.

I call particular attention to the fact that consumers are "bought up" and they have been borrowing their heads off in an effort to keep up their standard of living. With the consumer's savings rate down to around 2.6% (lowest in history) and the consumer debt structure as high as Mount Everest, I am afraid that the American consumer is about to pull his horns in -- in a major way.

If there's one thing the American public understands, it's a crash on Wall Street. The crash has occurred, and we'll soon see how consumers take it. My guess -- it's "cool it" time for the man on the street, and there's a cold wind blowing for America's storekeepers. If so, we're going to see a tough recession in the US (remember how the retail stocks started crashing, even before the general market started down in mid-October?).

Question: Russell, I note that all along you have emphasized that you put your trust in "action of the market" indicators. This is what the PTI and DowPow is based on. How do you feel about these indicators now?

Answer: The action of the market indicators are the ones that really called this bear market. A surprsing number of the other indices failed miserably.

For instance, prior to the crash, stock margins were at record highs (this is supposed to be bullish), mutual fund cash was high (bullish), the short interest was very high (bullish), odd lotters were heavy sellers (bullish), Barron's Confidence Index was very high (bullish), insiders were definitely on the buy side (bullish), 1987 was a pre-election year (bullish), and last but not least, women's skirts were thigh- high (super-bullish for the market and for girl-watchers). What did it all add up to? A lot of deception! No, I'll stick with my time-tested studies of market action, thank you!

INVESTMENT POSITION: New subscribers are calling or writing to say, "I wasn't getting your Letters when the crash came, and my broker told me to sit tight. But the crash buried me, so what do I do now?"

And I tell them, "I wish I had the perfect answer or even a good answer for you. Normally, following a crash, the Dow will rally for around a 50% recovery. If it can do that this time, we'll get up around 2230 on the Dow -- IF it can do that. So that would be the ideal time to sell.

But no one knows exactly how this thing is going to unwind, and on that basis, I go back to my basic principle which states, "Be invested in a bull market, and be in cash in a bear market." Maybe that says it all.

NOTES & QUOTES: You may have saved the October 20 newspapers. I know I did. And, of course, the headlines were dramatic and historic. The reason I saved it is that I have five kids, three in their 20s or 30s and two of them 6 and 9 years of age. My 9-year-old, a boy, is already interested in finance, and he asks me endless questions about business and the markets. I saved the October 20 NY Times and WSJ for him.

I wanted to be able to show him what can happen, despite the fact that the "experts" had comforted us for years with the thought that "there can never be another 1929." These headlines tell us (1) that there are no "experts" when it comes to the stock market -- only experts for a while, (2) that the market can do anything, (3) that being on margin can be a ticket to bankruptcy, (4) that the strongest emotion on Wall Street is fear, and that greed runs a close second, and finally (5) that the markets move first and the economy will follow. This final lesson has not been proved yet, but I'm putting myself on the line here (in the form of a forecast) because I'm reasonably convinced (sad to say) that history will prove me correct.

For those of you who forgot to save the October 20 paper, I include the historic New York Times headlines on page 6. Save this Letter for your kids (or for yourself) as a reminder that every once in a while when stock buyers get crazy and when nonsense becomes the order of the day, Wall Street delivers a message. The message is always the same -- "the piper gets paid."

BONDS, GOLD: I'm running these items together in one section, because right now they're closely connected. Subscribers know that I was never particularly enthusiastic about the prospects for inflation over the foreseeable future. Black Monday (Oct. 19) has only fortified my doubts about any coming inflation.

Here are my thoughts, and needless to say, I could be wrong. I've felt all along that at the first sign of real inflation, the bond market would swoon, interest rates would go through the roof, business would sag -- and "the new inflation" would be killed before it ever got started. I still believe this.

I have been recommending monthly accumulation of the bullion gold coins as an "insurance policy" against a possible collapse in the system or as insurance against a complete collapse in the dollar. Actually, I don't think the system is going to collapse, and I don't think the dollar is going completely to hell. I think the system could take a beating, but I do believe there is enough international cooperation to hold the world's financial system together. As for the dollar, it will slide, it will zig-zag, but it isn't going to nothing overnight.

When the stock market crashed on October 19, perceptions changed overnight. You can see this "instant change" in the chart of the T-bond futures. The bond contract exploded with "runaway gaps" on the upside. It was the most violent reversal I've ever seen in bonds. At the same time gold, the metal, did very little while the gold shares began to peel off on the downside.

What were the bonds and the metals telling us? I believe they were telling us (1) that you can forget about inflation, at least for the time

"All the News That's Fit to Print"

The New York Times

NATIONAL EDITION
West: Southern California, coastal fog. Highs 65-73. Interior, sunny and warm. Highs 75-85. Rockies, some clouds, east-ern New Mexico. Mostly sunny, not as warm elsewhere. Weather map, page 34.

VOL.CXXXVII.... No. 47,298 NEW YORK, TUESDAY, OCTOBER 20, 1987 50 CENTS

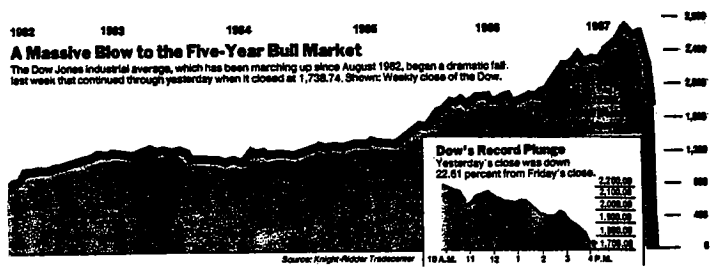
STOCKS PLUNGE 508 POINTS, A DROP OF 22.6%; 604 MILLION VOLUME NEARLY DOUBLES RECORD

U.S. Ships Shell Iran Installation In Gulf Reprisal

Offshore Target Termed a Base for Gunboats

By STEVEN V. ROBERTS

WASHINGTON, Oct. 19 — United States naval forces struck back at Iran today for attacks on American-registered vessels and other Persian Gulf shipping by shelling two converted off-



WORLDWIDE IMPACT

Frenzied Trading Raises Fears of Recession — Tape 2 Hours Late

By LAWRENCE J. De MARIA

Stock market prices plunged in a tumultuous wave of selling yesterday, giving Wall Street its worst day in history and raising fears of a recession.

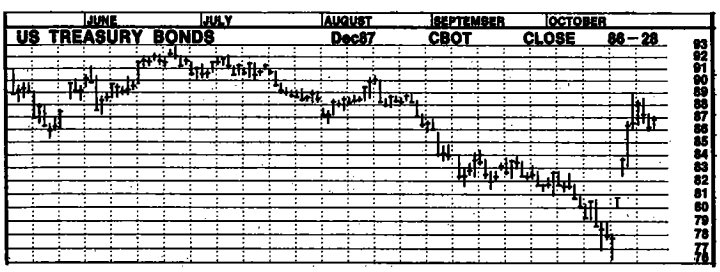
The Dow Jones industrial average,

being, (2) that there is a good chance of a recession or depression in the economy, and that means deflation, and lower interest rates in due time, (3) that INCOME and CASH FLOW are going to be the operative words over the foreseeable future, (4) that high-grade bonds with their fat incomes are a good place to be, (5) that gold bullion still rates as a fine insurance policy, (6) that gold shares were overpriced, provided little or no income, and were overdue for a fat correction. And they got the correction -- in spades.

For the bonds, the picture is mixed. The good news for bonds is that business is going to slow down (maybe a lot worse than slow down). And I see the slowdown as global in scope. When that happens I think you will see a concerted, international effort to bring rates down. If that occurs, bonds will be the place to be. But let me emphasize -- high-grade bonds. The junk bonds may not make it (as a matter of fact, I feel reasonably convinced that a LOT of junk bonds and LBOs aren't going to make it).

OK, the bad news for bonds is the US deficits and debts. They've got to be financed. Financing debts and deficits in a recessionary atmosphere is not easy. Furthermore, the weak dollar is bad for bonds. Foreigners (who finance maybe 30% of the US deficits) aren't going to buy US bonds when dollars (the item they are denominated in) are going down the drain.

So it's a trade-off, but ultimately I see rates coming down. Normally, long-term bonds offer yields about 3% above the inflation rate. If the inflation rate becomes zero or we have a 3% or 5% deflation rate, bonds yielding 8-10% become great values.

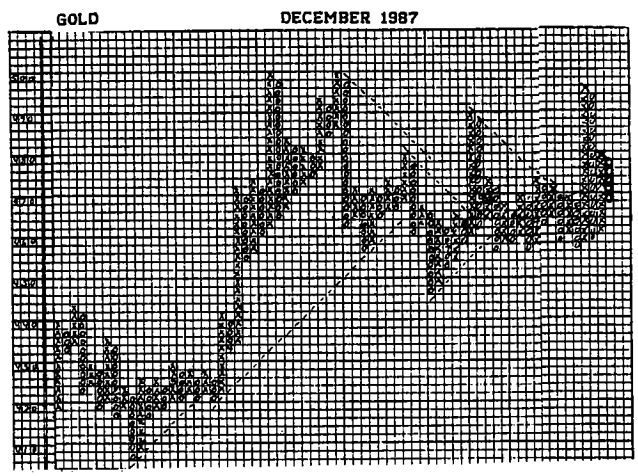


Anyway, since Black Monday the money has been made in high-grade bonds offering juicy yields. The money has been lost in low-yielding stocks of all types including gold stocks. The values have held fairly steady in gold coins and gold bullion. That's "the bloodless verdict of the market." Argue with it if you want.

A few more words about the gold shares. If gold continues in its bull trend, if gold continues to creep up, then in due time the gold shares are going to follow. But the gold shares got ahead of themselves. Too many salesmen were touting gold shares and holes in the ground that resembled gold mines. The big break in the gold shares cooled off the atmosphere.

But above all I think this -- gold items thrive in an inflationary atmospere. I don't think that's what we've got today. Therefore, as I have stated for the past two years, I buy gold coins for insurance purposes. That's all I buy them for.

Finally, the point & figure chart of the December gold futures is a strange one. Even after the big 12 dollar break last week, gold looks like it's building a big base. Frankly, the gold chart looks a lot stronger than one would think if one just watched the gold action. It would take a December gold futures price of 456 to turn this chart bearish. In the absence of 456, take it that gold (for whatever reason) is building a huge base.



LATE NOTES: Despite the expected rally, the stock market closed the week ending Oct. 30 down $856 billion in value from its August high. The broad Wilshire Index (based on the dollar value of all stocks) closed below its January 1987 low. The rally back (despite what you may hear) is not going to give the losers a chance to get their money back. No, a bear market seldom lets you get out even.

Is this the "big rally," which I told you to expect? Is this the rally which could recoup roughly 50% in the Dow (but not in the broad averages) of the losses sustained during the crash? It looks like it, but I can't be sure yet. **IF** the Dow can better its Oct. 21 peak of 2027.85 confirmed with a Transport bettering of 787.01, I would say, "yes, this is almost surely the big post-crash retracement."

Copies of my three **Barron's** bear market articles, Oct. 19, 26, and Nov. 2, available for $4, but please include a self-addressed envelope.

NEXT MAILING: Nov. 18